CONTROLLING BUSINESS CYCLES—DISCUSSION

N. I. STONE.—Business cycles with their concomitants of business booms and business depressions are characteristic of the capitalist system. I prefer the term "capitalistic" to that of "money economy" used by Professor Mitchell, because the economic system which prevailed in the days of the guild, when the producer was both worker and owner of the means of production, was also a money economy. For, to use Professor Mitchell's test, under that pre-capitalistic industrial system the primary function of man in society, the making of serviceable goods, took the form of making money, as it does now. Else, St. Thomas Aquinas and other mediaeval writers would not have been writing learned disquisitions on the subject of a "justum pretium." But the money economy of their day did not move in cycles. Marx's claim that the phenomenon of recurring business depressions is peculiar to the modern capitalistic system has never been disputed, to my knowledge, by any economic writer. The Socialist indictment of the capitalist system for its failure to function properly in what is the sole mission of its existence, has remained unanswered, for as Professor Mitchell says, Carlyle's moving description of the tragedy of British life in 1843 "applies as well to the United States in 1921."

The significance of Professor Mitchell's paper, to my mind, lies in the fact that the science of economics, and particularly applied economics, is awakening to the realization of the fact that paralysis of industry with unemployment and starvation need no more follow in the wake of the downward swing of industrial cycles than freezing to death need be caused by the winter phase of the weather cycle. This new conception marks a turning point in the progress of economic thought. Its successful application will give a new lease of life to our industrial order, and will make impossible the cataclysm which Marx predicted as the inevitable consequence of the choking of the capitalistic system with the productive forces it has conjured up.

The power of the Federal Reserve Board to regulate the flow of credit is so great and all-pervading as naturally to suggest the idea of its being used as a means of controlling the ebb and flow of industry. The thought is not new, as that is just what the Bank of England has been trying to do in Great Britain for more than half a century. The new departure is in Professor Mitchell's and Professor Sprague's suggestion to adjust the discount rate not with a view solely to financial tests, such as the reserve ratio, but by direct reliance on industrial symptoms such as an index number of physical production.

Since the bank is but the handmaiden of industry, there can be no valid objection to the proposition, except on the score of its feasibility. The latter is merely a matter of improved technique in our statistics of production and of wholesale and retail trade, which have been

woefully neglected hitherto, but which can be made available with adequate promptness and accuracy, once their need and usefulness are clearly realized. The proposition involves a much more intimate insight into the problems of industry on the part of controllers of credit than they have had any need of acquiring in the past. Incidentally, it opens up a new avenue for practical service to the economist and the statistician.

But the use of the discount rate as a means of regulating our business cycles can not be regarded as a panacea for industrial crises. The discount rate may help regulate; it can not create. It can be made to perform the functions of the flywheel and the governor in a steam engine. The steam engine, like our industrial apparatus, does its work in cycles. At each extreme point of condensation and expansion of the steam, which coincides with the rise and fall of the piston, the piston rod gets to what the engineers call a dead point; because of its motion in a straight line, the piston rod—and with it the engine—would come to a dead stop at either extreme if it were not for the flywheel, which by the force of its momentum continues to revolve and by means of the connecting crank starts the piston back on its journey to the opposite extreme from which it is brought out again by the revolving momentum of the flywheel.

The varying loads of work to which the steam engine is subjected in its cyclical operation would break it down if it were not for the "governor," a little centrifugal device which automatically reduces or increases the flow of steam to the cylinder in response to the varying needs of the work.

But neither the flywheel nor the governor will keep the engine going indefinitely, if the fire goes out under the boiler and the flow of steam stops for good. By the same token, increased or reduced rates of discount will not alone maintain our industry on an even keel. An advance in the discount rate will reduce industrial activity and, with it, opportunities for employment; a reduction in the rate will not of itself start up industries for whose product there is no ready market. Back of it all there must be the live steam of an effective economic demand for goods on the part of an employed population. The remedy for unemployment is employment. It is at this point that a regulated system of public works, and a more intelligently adjusted operation of privately owned plants comes into play.

Let me dwell on the privately owned plant first. The movement for continuity of production in such plants, which had its beginning in Great Britain, is as yet in its infancy in this country. Enough however, has been done by way of demonstration to indicate the possibilities in this direction. I happen to be in charge of one of three large clothing plants in this country which deliberately set about to

operate on an even keel throughout the year and have been successful in their efforts. If this could be achieved in an industry which is proverbially seasonal and is the first to feel the quickening and deadening effects of good and bad times, and is moreover subject to changes in style, if the Dennison Company could regularize its manufacture of Christmas goods throughout the year, not to speak of other examples, is it too much to expect that the steel industry might regularize the production of steel billets and rods and rails?

Unfortunately, progress in this field is dependent on individual initiative and intelligent study, and requires an outlook beyond the horizon of the counting-room of the individual business, which is a rare asset in our industrial world. In so far as it can be stimulated by a direct and palpable financial incentive, the proposal for unemployment insurance with a premium for each industrial plant based on the amount of unemployment in that plant, contains great educational possibilities (educational for our captains of industry) apart from the immediate relief from want for millions of people, idle through no fault of their own.

More important, because of its more concentrated effect, is emergency employment which can be furnished through public works. When it is considered that the amounts spent by our federal, state, county, and municipal governments on buildings, roads, bridges, tunnels, canals, harbors, docks, irrigation, drainage, and the deepening of rivers run into hundreds of millions, if not billions, of dollars per annum, the tremendous power which the damming up of these sources of employment in flush years and turning them loose upon the market when industrial activity slackens would have in stimulating employment can hardly be overestimated.

The indirect effects would be even greater than the direct, for the billions of dollars thus expended upon necessary materials, equipment, and wages would have their repercussive effect upon every industry in the land like the ripples which spread from a stone thrown into still water. The effective demand for every commodity which is produced for the satisfaction of human wants on the part of the workers and their families directly employed in these public works and indirectly employed in furnishing the building materials and equipment, would have a quickening effect on every industry in the country. Only in this way would banks feel prompted to extend credit to industries and make effective use of the reduction of the discount rate by the Federal Reserve Board.

It would thus seem that, if we are to cope successfully with the evil effect of industrial depression, both devices will have to be used to supplement one another. Although the difficulties in the way of a comprehensive handling of the problem are so great as to have seem-

ed insurmountable until recently, the outlook at present seems promising. Already the federal government has greatly stimulated the building of roads by its system of sharing the cost of construction with the states. The unemployment conference under the leadership of Secretary Hoover has resulted in prompting public authorities to push public works at this time to the limit of their authority. What we need most, is legislation which would permit our public authorities to expend the appropriations for public works at such times as conditions will warrant over a period of say five to ten years, instead of their being available only for the current fiscal year, as is the present rule.

Senator Kenyon's measure entitled "A Bill To Prepare For Future Cyclical Periods of Depression and Unemployment by Systems of Public Works" introduced in the United States Senate last month aims at this end. Though susceptible of improvement in detail, it would go far toward approaching this goal. In addition, it vests the Secretary of Commerce with power to publish monthly reports on business conditions and to "obtain such additional facts and statistics as may be necessary to carry out the provisions" of the bill. Under this simple provision, it would be possible, under the bold leadership for which the present head of the Department of Commerce is known, to organize the collection of the statistical information which Professor Mitchell has outlined as so urgently necessary, and the foundation would thus be laid for still greater achievement in the future.

Both from the broad viewpoint of the best interests of the country and from that of our immediate interest as workmen in improved tools, it behooves us all to exert our influence for the adoption of the Kenyon Bill. (S 2749)

W. C. Schluter.—The problem of controlling the wide variations in business conditions centers primarily upon the understanding of the workings of our money economy and the principles that determine the several phases of the business cycle. The augmented degree of elasticity that our credit system has acquired because of the efficiency of the reorganized banking system and because of the enormous accretion to the gold supply makes some kind of control over the upswing of the business cycle seem necessary. Again, whether considered from the private acquisitive or social viewpoint, human interest in the millions of moneyless unemployed and in the elimination of economic wastes as a result of idle industrial equipment ought to elicit support for plans that aim to moderate the business depressions.

The chief obstacles involved in the problem which seeks to devise ways and means toward moderating the upswing and downswing of business conditions are the traditional aversion in America to centralization of power and control over private conduct, and the traditional

propensity to acquire immediate profits and "to cut the melons as they ripen." These two factors so deeply ingrained in our habits of thinking can only be rendered less tenacious by education. The process of education will take time and patience, but the war has helped to make the average mind more susceptible to suggestions in this respect. Along the line of meeting the above traditional aversion and practice, the following methods of education should not be overlooked in proposing plans for controlling the business cycle. First, sufficient data should be obtained, not only for the purpose of understanding the workings of our money economy and of formulating policies of control, but also, and of no less importance, the efficient utilization of the data in order to make a convincing appeal to those whose change of attitude is desired in behalf of the plans proposed for controlling the business cycle. Secondly, especially does it seem necessary to organize courses in business cycles in the universities and colleges. These courses should involve the study of the principles of business cycles, the analysis of business conditions, the intelligent and practical utilization of the data offered by business reporting services and the training in making scientific business forecasts for particular businesses as well as for general business conditions.

The policies of control to moderate the upswing of the business cycle that are generally agreed upon as practical measures involve the restriction on the uses of bank credit. Recognizing the basis of facts with reference to the credit system in this country, the relative importance of the banking resources held by the twelve federal reserve banks as compared with those of the 30,000 member and non-member banks seems small. It is difficult to see how the control by the federal reserve discount rate can be made effective until the wide elastic margin that the national and state banks' resources possess has become narrowed by the normal economic growth of the country. As the situation stands, the business maladjustments will certainly become serious before the resources of the 30,000 banks have become exhausted. Besides waiting for the economic growth of the country, or perhaps a loss of gold through export, to reduce these surplus banking resources, a concentration movement among the 30,000 banks might aid control over credit, but this development seems extremely doubtful because of traditional and legal restraints. Nevertheless, the immediate fundamental requirements that the federal reserve discount rate should be kept above the market rate at all times ought not to be difficult of attainment. The history of European central banking practice, even though a greater mobilization of banking resources existed there than in this country, reveals the primary need of keeping the central bank discount rate above the market rate. And, since the English bank rate was generally above the French bank

rate, while the German bank rate was above the English, it seems advisable that the federal reserve discount rate should be kept above the German rate, granting relative comparability of conditions now with those that existed in the respective countries before the war. The factors that caused this difference in the rates of Germany, England, and France were the wider margins of profits in industry plus the less determinateness or greater fluctuations of the market rate. Since these factors are present to a greater degree in the United States, the reasons for higher discount rates become apparent. Again, it must be recognized that the central bank rates in Europe before the war had an additional significance for those countries because of the preponderance of foreign trade relative to the domestic trade and the close interrelation of the European credit markets, making thus necessary the use of the bank rate to conserve the already economically used banking resources for the respective countries.

The problem of long-range planning of capital expenditures to moderate the business depressions involves certain practical difficulties. The traditional dividend policies of concerns as well as the attitude of the investors would make the adoption of such plans on the part of private enterprises quite improbable. The methods of managing business capital would have to undergo considerable changes in the direction of meeting scientific standards of capital requirements over long periods. Such also would be the difficulties if the plan were adopted by railroads and public utilities. The undertaking of capital expenditures in periods of depression should only be attempted if an effective control over the uses of credit could be established. The billions of dollars that could be thus expended with the employment of the necessary labor would contain all the seeds of a business boom. There are other considerations. The strain in the investment market is only relieved after the decline in business activity has set in. The conditions for capital application become favorable after the disorganization and unemployment of the personnel in the industrial plants has already taken place. The business readjustments upon a new basis of cost would render the calculations of the amount of capital required very indeterminate. The immobility of labor would necessarily limit the scope of the possible reëmployment of labor. Perhaps only the laborers in the construction industries would be benefited unless the whole business system would again be stimulated into a state of revival. Finally, the interferences with the liquidation process that would become possible under such plans might place undue burden upon the marginal laborers and business concerns. The irregularities in the movement of prices might also become greater if capital expenditures were undertaken in periods of depression. If it is true that we are entering a long period of falling prices with inter-

mittent short-time price recoveries, the application of these plans would probably meet with more unfavorable conditions.

Nevertheless, these difficulties are only pointed out here to open up further aspects of the problem of controlling the business cycle by these proposed schemes. Practical tests of well devised plans along these lines should meet with the support of those interested. These experiments should be welcomed.

In conclusion, it might be suggested that there is another approach to the problem of controlling the business cycle which has thus far not been wisely sponsored. Dr. W. C. Mitchell has pointed out in a scholarly manner the fundamental nature of our money economy, the necessity of procuring adequate data with reference to its workings in order to effect better means of control toward the end of greater human welfare. It is difficult to disagree with him in this matter. Then, must we not recognize that a more coherent organization of the money economy would offer a better basis for control and more homogeneous data with reference to its workings upon which policies of control could be better formulated? Economic evolution is distinctly toward concentration of markets and of business enterprises in the industrial as well as in the financial field. It is only necessary to point to the development of the system of industrial and banking Kartels in Germany before the war. Since the war the movement toward concentration of business enterprises has received added impetus. The recent experiences in England and Germany offer illuminating evidence. The movement has struck root in this country. As examples, one might cite the Cleveland bank consolidation, the proposed steel combine of the independent concerns, and the Ford industrial integration. It is true that the traditional aversion in America toward consolidation and combination of business enterprises is deeply rooted. But the development is obviously in that direction. Federal supervision over the large business concentrations might be substituted for the present harrassing state control. Would not efficient, directive policies inaugurated toward the end of properly fostering the movement of concentration in American fields of banking and industry lead toward a better organization of our business system, more homogeneous data as a basis of control, and be more fruitful of results over a given period than the various plans proposed? Would not some consolidation within the 30,000 banks in this country aid toward the control of credit? Would not production and prices become more stabilized and the prices in the price system keep a more consistent relation toward each other under a system of greater business concentration? Recognizing the practical limitation upon the size of business units which would involve the law of diminishing returns in productive efficiency, nevertheless, the tying together

of the various large enterprises could be obtained through Kartelling as, for example, in Germany and England. It is realized that these suggestions open up intricate and vital questions, but policies formulated along these lines would lead to a more expeditious control of our business life, for we would be swimming with the current of development of our industrial and financial enterprises.

WALTER W. STEWART.—The preceding papers have raised, in sharp fashion, this question: Can men learn to control the institutions under which they live or must men continue to be controlled by them?

Professor Mitchell believes that since these institutions are rules of our own making they are subject to amendment; that in order to carry out a revision we need fuller statistical information, a clearer comprehension of the influence of institutions upon our economic behavior, and a courageously constructive attitude toward the problem. My comments bear upon these last two points, upon the influence of institutions and upon the attitude of economists. More specifically, I wish to consider the consequences for investors and for workers of the business policy pursued during depressions, and to suggest a method by which further control might be secured.

The primary consideration of the corporate management during a period of depression, when earnings are declining, is to protect the solvency and credit of the corporation. In pursuit of this policy provision is commonly made toward stabilizing the incomes of investors in corporate securities. A default in interest payments leads to such serious financial consequences that the management bends every effort to maintain the income of bondholders even though these payments cannot be met out of current earnings. Likewise the harm done to the future credit position of the corporation by passing or reducing its dividends puts pressure upon the management to maintain also the dividend payments; the surplus earnings of the prosperous years are, therefore, made available to the owners of stock during years of depression. Thus during the present year of depression the profits of corporations have declined abruptly, yet the monthly distributions of interest and dividends have continued as in prosperous years.

In contrast, during the year 1921 the wage incomes of approximately 4,000,000 industrial workers completely disappeared. This, too, is part of the accepted policy for dealing with a depression when the financial position of the corporation is at stake. Confronted with unprofitable markets the management decreases the pay roll by the discharge of workmen. When production ceases to be profitable a decrease of even 25 per cent in wage rates appears ordinarily not to be a sufficient protection to the corporate property; what is usually required is a complete cessation of wage payments by the discharge of workmen. The only way, apparently, by which large economies

can be made when prices are declining is at the expense of labor. The maintenance of the pay roll is a problem of greater magnitude than the maintenance of interest payments—a problem which corporations have not solved, and which, acting individually and competitively, they probably cannot solve. The pay roll cannot be maintained without a maintenance of production. Production and solvency cannot both be maintained at a time when there is no market for the product. Under these conditions a decrease in the pay roll by the discharge of workers is as essential to corporate solvency as the maintenance of interest payments.

Unemployment among industrial workers is the corollary of the decreased production of manufactured goods. The sequence by which this reduction of output proceeds cumulatively from one industry to another and back again to the place of beginning is familiar enough. Each successive corporation, in the effort to save itself, increases the difficulties for all; its discharge of workers cuts off the buying power from which orders ultimately arise. Such a policy, though perhaps expedient or necessary when corporations act individually and competitively, is ruinous collectively.

Unemployment is not the outcome of deliberate intention; rather it is the unintended consequence of a policy with other aims. But the consequences are none the less severe because they are unintended. In like manner the provisions for stabilizing the incomes of investors are not thought of by the management as methods of dealing with the business cycle; they are the by-products of a policy intended to avoid bankruptcy and protect credit. In the control of business cycles, however, we are less concerned with the intentions of the corporate management than with the consequences of a business policy upon economic behavior and welfare. The point is, that a policy based upon financial considerations which bring a degree of security to the investors brings insecurity to the workers.

Investors are doubtless more willing to bear patiently with the irregularities of production and employment than they would be if their incomes and investments suffered in proportion to the irregularity of corporate earnings. Farmers and city workers, however, who have borne the brunt of the depression, appear to be less patient. Their incomes have suffered most heavily and they are in a mood to revise the accepted rules for dealing with a depression. If constructive changes could now be proposed, their interest might be enlisted and a greater stabilization of industry secured.

There have been suggestions for the stabilization of price and production through the control of credit by the Federal Reserve Board. Perhaps economists turn toward banking as a means of control because the Reserve Board seems to be the only organization acting in

the public interest which has the authority and power to make its decisions effective. I agree that in its rediscount policy the Federal Reserve Board should keep in mind the price level and the production level as well as the reserve ratio and prevailing conditions of credit. A change in the rediscount rate, however, is a feeble instrument for making effective a judgment and a will which may differ from the will of the banking and business community. The primary decisions which determine the volume and character of bank loans are made at the place of original discount. In fact, the rediscount policy of 1920 was finally made effective not by the advance in the rate of rediscount alone but by the actual discrimination at the source against certain kinds of loans. Those who approach the problem of industrial stabilization through the control of credit do not ordinarily contemplate the rationing of bank loans by a central authority, yet it is probable that if the attempt were made to restrict the total volume of loans at a time when banking reserves were still adequate the policy would be brought face to face with that issue.

Entirely apart from the effectiveness of the rediscount policy, however, the character of the organization of the Federal Reserve System has shown the possibilities of a certain type of economic organization. The experience in the recent crisis proved the wisdom of transferring certain functions which formerly were under competitive management to a board whose decisions and actions are free from the pressure of business competition. It will be remembered that so long as the responsibility for the ultimate banking reserves remained with the bankers' banks in New York the policy pursued in a crisis did not permit the making of loans to solvent borrowers, nor did it prevent a suspension of cash payments. Each banker, in the effort to save himself, created a situation from which none could escape, and the crisis became a panic. Finally the Federal Reserve Act made a distinction between the management of a banking system and the management of a bank, and took the final responsibility for reserves out of the hands of the individual bankers. Banking panics had arisen out of the competitive management of banking reserves; they disappeared when those reserves were centralized and brought under a unified control.

The uncontrolled and competitive management of production and the free and competitive determination of price now lead to consequences quite as disastrous. Buying power depends upon both price and output, and a collapse of either—at the farm or in the factory—causes a breakdown in the exchange of goods. A proper organization of that vast system of markets and prices which stands between and connects the farm and the factory would cause the products from these two sources to mutually and continuously support one another.

It is possible that by a redistribution of functions in the fields of production and price control could be established. In all save certain specific matters discretion could be left with the individual business enterprise, but in other matters the decisions might be made by an agency organized on a non-competitive basis and acting in the interest of the general welfare. The need for protecting competitors from themselves is as great in the field of production as it was in the field of banking. A plan which attempts that might run counter to the accepted principles of competitive management, but so did the plan for the reorganization of banking. The problem of controlling the business cycle is a large undertaking, and we need not delude ourselves that it can be achieved by slight modifications in the existing scheme of control.

Whether the men of this generation learn to control the institutions of the money economy depends, in large part, upon the attitude toward the problem taken by the economists. If economists continue to believe that corrections will automatically be applied by the free and unregulated operation of market forces, then the cyclical fluctuations of business may continue much as they have in the past. Those price oscillations which prevent production and disturb industry will continue, along with other price changes which are useful in the guidance of production, until the economists undertake to distinguish between the two. If the price system need not yield periodically to the action of the planet Venus, then surely it might be expected to show some resistance to the action of "natural law." Natural law in the industrial world is a statement of the consequences which flow from rules of our own making. A modification of these consequences as they appear in business cycles can be secured only by a revision of the rules. Any such revision inevitably carries with it some risks, but farmers and workers, I imagine, might be willing to share in these new risks as a means of avoiding or sharing with others the risks which they now bear alone. Economists, by participating in the revision, might help to make the new rules practicable and adequate.